

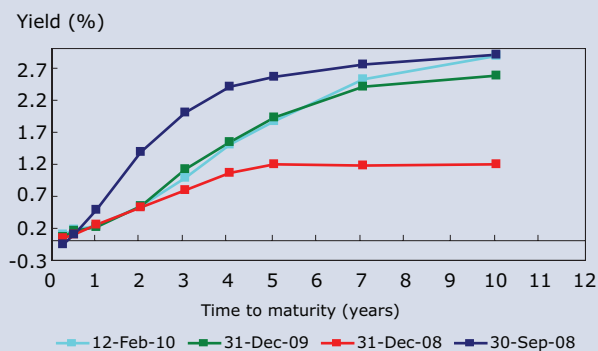
Hong Kong, China—Update

Yield Movements

Yields on Hong Kong, China's Exchange Fund Bills and Notes (EFBNs) as of 12 February, compared to their levels at end-December 2009, increased marginally at the very short-end, declined at the belly, and rose at the long-end of the curve. Yields rose slightly at the short-end, increasing between 1 basis point (1-year bills) to 3 basis points (3-month bills). At the belly of the curve, yield declines ranged from 0.6 basis points (2-year notes) to 13.6 basis points (3-year notes); while at the long-end of the curve, yields on 7- and 10-year notes rose 10.2 and 31.3 basis points, respectively.

As a result of the large rise in yields at the long-end of the curve, the spread between 2- and 10-year EFBNs, which stood at 202.8 basis points as of end-December, rose to 234.70 basis points as of 12 February. These yield movements, particularly at the short-end, reflect the low-interest environment of Hong Kong, China. The value of the Hong Kong dollar is pegged within a narrow band, to the United States (US) dollar and, consequently, short-term domestic interest rates tend to be closely aligned with US interest rates.

Figure 1: Hong Kong, China's EFBN Yield Curve



EFBN=Exchange Fund Bills and Notes.
Source: Bloomberg, LP.

Size and Composition

As of end-December, the outstanding amount of government bonds—comprising EFBNs and bonds issued under Hong Kong, China's newly-introduced Institutional Issuance Program—reached HKD540 million for a 242% year-on-year (y-o-y) increase (**Table 1**). The rise in government bonds outstanding largely resulted from the issuance of Exchange Fund Bills by the Hong Kong Monetary Authority (HKMA) to accommodate significant bank demand. As capital has continued to flow into the Special Administrative Region, banks' reserve accounts with the HKMA have been rising, thereby increasing Hong Kong, China's monetary base and boosting demand for short-dated EFBNs. EFBNs are key instruments for liquidity management purposes since they are eligible as collateral for borrowing from the HKMA through repurchase agreements.

At end-December, the amount of Exchange Fund Bills outstanding surged 411.7% y-o-y and 35.2% quarter-on-quarter (q-o-q) to HKD464 billion. By contrast, the stock of Exchange Fund Notes at end-December grew more modestly, by 4.2% y-o-y and 0.1% q-o-q. In January, continuing a trend seen in 2009, the HKMA announced it would increase issuance of Exchange Fund Bills for the month by a total of HKD35 billion to accommodate strong bank demand.

The local currency corporate sector of Hong Kong, China's bond market, as in previous years, was restrained in 4Q09, with the outstanding amount of corporate paper rising only 3.3% y-o-y and declining 0.4% q-o-q to HKD577 billion.

Policy, Institutional, and Regulatory Developments

Institutional Issuance Program Bonds

In July, Hong Kong, China's Legislative Council approved the Special Administrative Region's Institutional Issuance Program. Under the

Table 1: Size and Composition of Local Currency Bond Market in Hong Kong, China

	Amount (billion)						Growth Rate (%)								
	Sep-09		Oct-09		Nov-09		Sep-09		Oct-09		Nov-09		Dec-09		
	HKD	USD	HKD	USD	HKD	USD	y-o-y	q-o-q	m-o-m	y-o-y	q-o-q	m-o-m	y-o-y	q-o-q	m-o-m
Total	996	129	1,018	131	1,054	136	39.0	15.4	2.2	3.5	55.8	12.1	5.9		
Government	417	54	440	57	476	61	187.3	44.4	5.5	8.4	242.2	29.5	13.3		
Exchange Fund Bills	343	44	366	47	402	52	333.2	56.2	6.7	9.6	411.7	35.2	15.6		
Exchange Fund Notes	70	9	70	9	69	9	5.9	1.5	0.0	(0.9)	4.2	0.1	1.0		
HKSAR Bonds	4	0.5	4	0.5	6	1	—	—	0.0	57.1	—	57.1	0.0		
Corporate	580	75	579	75	578	75	1.4	0.9	(0.1)	(0.1)	3.3	(0.4)	(0.1)		

— = not applicable, HKSAR = Hong Kong Special Administrative Region, m-o-m = month-on-month, q-o-q = quarter-on-quarter, y-o-y = year-on-year.

Notes:

1. Calculated using data from national sources.
2. Bloomberg end-of-period LCY—USD rates are used.
3. Growth rates are calculated from LCY base and do not include currency effects.
4. The amount of corporate bonds outstanding for October and November were estimated based on the compounded monthly growth rate between September and December.

Source:

Hong Kong Monetary Authority and Bloomberg LP.

program, the government is authorized to issue debt amounting to HKD100 billion over the next few years, with the aim of helping develop the domestic bond market and providing a benchmark for the pricing of corporate debt. Bonds issued under the program are liabilities of the Government of the Hong Kong Special Administrative Region, unlike EFBNs, which are backed by foreign reserves under Hong Kong, China's currency board system.

Following the initial sale in September of HKD3.5 billion of bonds under the program, HKD2.0 billion of 5-year bonds and HKD2.5 billion of 10-year bonds were issued in November 2009 and January 2010, respectively.

Issuance of the People's Republic of China's Treasury Bonds in Hong Kong, China

The People's Republic of China's (PRC) Ministry of Finance said on 20 October 2009 that its CNY6 billion treasury bond offering in Hong Kong, China attracted subscriptions totaling three times the offered amount. The sale, which capitalizes on Hong Kong, China's role as an international financial center, is seen as part of the PRC's efforts to broaden the use of the yuan internationally and further develop Hong Kong, China's bond market.